

NOTICE OF INQUIRY/RULEMAKING ESTABLISHING PROCEDURES TO BE FOLLOWED IN ELECTRIC INDUSTRY RESTRUCTURING

I. INTRODUCTION

Fitchburg Gas and Electric Light Company ("Unitil/FG&E")¹, a member of the Unitil System of Companies, supports the Department of Public Utilities' (the "Department") initiatives to encourage the development of a state-wide competitive market for the generation and retail marketing of electricity.

Unitil/FG&E believes it is critical for the Department to develop a restructuring plan by focusing on the goals and optimal market structure that would best serve the needs of customers. Based upon that plan, the Department should establish procedures for the transition that will be fair and equitable to all stakeholders, and seek appropriate statutory revisions to modify the existing legislative scheme.

The overall structure proposed by the Department is an important step toward the goals of customer choice, reliability and the across-the-board benefits. There are, however, certain important modifications to the Department's proposed rules that Unitil/FG&E believes are necessary to ensure optimal market efficiencies.

- The key market power issue which has not been adequately addressed to date is the need for effective separation between the ownership and control of generation and the ownership and control of transmission. Possible divestiture of generation assets is not the right question; it is the possible divestiture of transmission assets that needs to be addressed. Ultimately, the operation of a truly independent system operator ("ISO") may require that all transmission assets, owned by utilities which control generation, be transferred to an independent system

¹ Unitil/FG&E is a wholly-owned subsidiary of Unitil Corporation, a multi-state holding company, which also owns two New Hampshire electric utilities, Concord Electric Company and Exeter & Hampton Electric Company. Unitil/FG&E's affiliates have been actively involved in the electric industry restructuring initiatives in New Hampshire, including the Retail Competition Pilot Program.

owner-operator ("ISOO"), in order to avoid abuses of market power and to ensure necessary expansion of the transmission system.

- The only significant market power risk posed by common control of electric distribution and retail marketing is an unfair information exchange; the distribution company providing customer information exclusively to a marketing affiliate. This potential abuse can be adequately addressed by imposing threshold limitations on the participation of affiliated marketers in a distribution company's service territory.
- Transmission and distribution functions, as well as electric generating and retail marketing, must also be operationally separate. This functional disaggregation can be accomplished through appropriate standards of conduct that include exemptions for small distribution companies, or for service territories where there is robust competition.
- Distribution companies should not be the suppliers of last resort in a restructured industry. In order to create a fully competitive market, there must be a separation between the distribution and energy supply functions. There are other mechanisms, which will not distort the market, that can be utilized to ensure service to all customers and to provide subsidies to low income customers.
- The Department's fundamental restructuring of electric utilities is not consistent with the existing statutory scheme for regulating the monopoly sale of electricity. The Department should identify and seek necessary statutory amendments to ensure the legal viability of its restructuring initiative.

Unitil/FG&E offers the following brief comments on these and other selected topics. Unitil/FG&E intends to also address these issues in oral testimony at the hearings in this proceeding.

II. SPECIFIC COMMENTS

A. Market Power Concerns

In establishing rules for electric industry restructuring, the Department needs to guard against potential abuses of market power that may frustrate the goals of competition in electric energy markets. Beyond the general market power concerns which arise in any competitive market, for which there exist antitrust and consumer protection laws, the Department needs to be specifically concerned with market power that results from the action, or position in the market, of a regulated monopoly affiliate. Vertically integrated firms which house under the same corporate umbrella both unregulated competitive electric generation and retail marketing functions, together with regulated transmission and distribution functions, provide opportunities for the abuse of market power.

Unitil/FG&E believes that the most important market power issue is the link between electric generation and electric transmission. Unitil/FG&E wholeheartedly endorses the concept of an ISO who will be charged with the operation and information management functions of the transmission system. In Order 888, the Federal Energy Regulatory Commission ("FERC") has embraced the concept of an ISO to address the potential for market abuse through manipulation of transmission operation and information management. However, this solution may fail to address a more fundamental issue relating to the ownership and management of transmission assets. This issue centers around who will make the ultimate decisions regarding construction of new transmission facilities and infrastructure upgrades, and whose interests are involved in setting transmission pricing policy. Decisions regarding transmission facilities have the potential to significantly impact the relative value of generation assets, by virtue

of the location and severity of transmission system constraints. Thus, a linkage of transmission and generation asset ownership through a common corporate parent may provide an opportunity for significant exercise of market power over generation and retail marketing competition through transmission facility siting decisions.

Furthermore, as discussed below in the section on transmission access and pricing, companies owning both transmission and generation assets will have substantial incentives to manipulate transmission pricing and contracts. Unital/FG&E suggests that the divestiture or spin-off of transmission facilities into an ISO - independent system owner-operator - must be considered as an option for the proper structure of the electric industry.

A secondary market power issue is the link between electric distribution and electric retail marketing, the retail manifestation of the competitive electric generation industry.² Electric distribution is functionally distinct from electric transmission in that it serves almost exclusively to connect radially distributed load centers with the transmission grid, and consequently plays virtually no role in the bulk transmission and wholesale trading of electric generation. Therefore, the only significant market power risk is an informational one: can the

² It is important to distinguish between the electric generation function and the electric retail marketing function. The goal of restructuring is to ensure competition in both the production (generation) and sale (retail marketing) of electricity. While some market participants may be engaged in both generation and retail marketing, these functions are separate and distinct. Competition currently exists in the generation and wholesale sales of electricity as a result of federal initiatives. The retail marketing of electricity, however, will only become competitive as a result of state-mandated unbundling of utility services such as that proposed by the Department.

distribution owner/operator provide a significant and unfair advantage to a competitive marketing affiliate through the misuse of customer information.

Unitil/FG&E believes that the risk of such abuse is largely a function of whether the retail competitive market operating within the distribution company service area is robust enough to provide a strong policing of the distribution company activities. The appropriate measures of robust retail competition are: (1) what portion of the distribution company customers are served by nonaffiliated retail marketers, and (2) how strong are those marketers relative to the horizontal market size of the distribution company. Unitil/FG&E believes that thresholds limiting the participation of an affiliated marketer in a distribution company service area, varying in conformity with the size of the distribution service area, should be imposed in order to ensure that distribution companies' market power is not abused.

In addition, Unitil/FG&E also agrees that the transmission and distribution functions must be functionally separated from each other, as well as from electric generation and retail marketing. Functional separation must be at least as distinct as that provided through corporate separation (separate accounting systems, delineation of personnel, etc.), and should be accompanied by appropriate standards of conduct designed to ensure that the transmission and distribution companies do not provide information or access to affiliated generators/marketers which they do not provide to nonaffiliated competitors. However, with respect to distribution companies, these standards of conduct should be tailored to reflect the level of retail competition. Specifically, the Department need not be

particularly concerned about small distribution companies or municipal distribution companies, where the retail marketers operating in their service areas are likely to be much larger and very aggressive. In such cases, "light-handed" standards of conduct, which do not significantly undermine the efficiency of these smaller organizations, will be sufficient.

Unitil/FG&E's affiliates have been addressing this same issue of appropriate standards of conduct in the context of the Retail Competition Pilot Program in New Hampshire. In that proceeding, one party has recommended adoption of the Massachusetts standards of conduct, which Unitil/FG&E supports. Unitil/FG&E's response to this recommendation, and explanation of how it complies with these standards, is included herein as Attachment A.

B. Transmission

In order to have a fair and competitive marketplace in New England, equal access to the transmission system, either on a Regional Transmission Group ("RTG") or ISO basis, will have to be implemented. Duplicate charges for service by local utilities pancaked underneath the RTG or ISO service will erect significant barriers to competitive power markets. Pancaking can take the form of horizontal pancaking (across multiple transmission systems) or vertical pancaking (multiple additive transmission charges within a system). In either case, the company attempting to bring generation resources across more than one transmission system will pay duplicate transmission charges totaling more than the operational value of interconnecting with the system, thereby eroding the

pricing benefit gained through competition. It is essential that the ISO or RTG service supersede all appropriate local transmission services.

Under FERC Order 888, Pool Transmission Facilities ("PTF") transmission service through the NEPOOL Agreement may well be considered discriminatory and may need to be replaced with higher ISO or RTG rates. To the extent that is the result, stranded benefits will be incurred by Pool Planned Unit owners since the initial investments in those units was encouraged through the favorable pool-wide rates. Specifically, utilities like Unital/FG&E were encouraged through PTF to buy into generation facilities, which have now become a significant portion of their generation portfolio. If the favorable PTF rates are eliminated, some of the value associated with those assets will be stripped out of Unital/FG&E's system and transferred to transmission owners in the form of increased revenue. Recognition and recovery of this stranded benefit is appropriate in the emerging competitive marketplace as a valid transition cost.

Under the current FERC open tariff scheme, companies that "impute" charges for their own use can make no actual payment, resulting in a lower actual earned return, but give themselves an advantage on the power markets and build market share. This can only be dealt with by separation into separate generation companies and transmission companies.

Recent filings by some transmission companies have resulted in claimed transmission cost of service increases of 200% or more as they move into the world of "open" transmission access. These filings need to be reviewed in great detail to verify that generation costs, distribution costs and inappropriate costs

allocations are not buried in the transmission cost of service, which would enable that transmission company's affiliates to have an inappropriate competitive advantage on the generation and/or distribution side of their business.

Transmission customers should also be allowed to select the type of transmission service they desire for access to a portfolio of power supply alternatives which they may have and which may change from time to time. Some power purchases may not need to be delivered on a firm basis; others may require either firm point-to-point or firm network service to maintain reliability and cost-effectiveness. To the maximum extent possible, the customer should be allowed to choose the type of service that fulfills its needs.

Unitil/FG&E's above-described concerns in regard to transmission service are exemplified in recent filings by several New England utilities, including NEES Transmission. Unitil/FG&E has filed a protest with the FERC, objecting to the NEES proposed transmission tariffs. A copy of Unitil/FG&E's protest is included herein as Attachment B.

C. Power Exchange

A power exchange will arise naturally out of the competitive market, once NEPOOL changes to a bid-based dispatch system rather than cost-based dispatch. The formation of this "commodity exchange," however, will be discouraged if regulators attempt to force such an arrangement. Therefore, this matter should be allowed to evolve under market forces, and should not be structured or regulated by the Department.

D. Municipals

To maximize the benefits of competition, municipals should be allowed to compete with IOUs only if the territories of each is open to the other.

E. Competitive Suppliers

_____ While the Department should not be involved in regulating prices in a competitive market, it should regulate market entry of suppliers, marketers and aggregators to ensure that such entities are competent to provide an essential commodity and to protect consumers from abusive practices. Requiring a certification process, in which suppliers must demonstrate their managerial, technical and financial ability to provide adequate service, would not create barriers to legitimate competitors while allowing the Department to impose minimum standards for non-discrimination and access. Moreover, the certification process would provide an avenue for customers to seek relief from unfair trade practices by granting the Department the ultimate authority to revoke a supplier's certification. The Department, rather than distribution companies, should assume responsibility for mediating disputes between suppliers and customers.

F. Distribution Franchises

1. Distribution Companies Should Not Be Suppliers Of Last Resort

Unitil/FG&E believes that the preliminary proposal of the Department to designate the distribution company as a supplier of last resort will substantially undermine the development of a fully competitive retail market for electricity. The distribution company must be removed completely from the provision of retail electric energy services, and all customers must be brought into the

competitive market, in order to ensure that that market develops fully and without the confusion and interference of a "shadow-regulated" market participants operated under the auspices of the distribution company.

Unitil/FG&E believes that keeping distribution and energy supply functions distinctly separated is important to ensure that these functions do not get confused in the marketplace.

Unitil/FG&E recognizes the Department's concern for universal service and low income customers, but believes there are better solutions to the problem which will encourage, rather than frustrate, full competition. Under full retail competition for electric energy, Unitil/FG&E expects development of an extremely strong and comprehensive market, which will actively search for and reach virtually every customer in the Commonwealth, large or small, rich or poor. The Department's role should be to ensure that the competing suppliers operating in this market operate in accordance with minimum standards of nondiscrimination and access, which can be accomplished through a supplier certification process and enforcement of the standards set forth in the draft rules.

However, there will continue to be a residual, and hopefully small, unassigned customer load pool, resulting from customer failure to act, supplier terminations and emergency service.³ The energy requirements for this unassigned load pool will need to be assigned to one or more electric energy suppliers, and this could be accommodated in different ways. Two examples: (1) In a similar manner to an assigned insurance pool, these loads would be

³ This is the service referenced in D.P.U. 96-100 as Basic Service.

allocated proportionately to all suppliers operating within the distribution company area, or across the Commonwealth; (2) The unassigned load pool could be sent out to bid among the competing suppliers in accordance with Department prescribed procedures -- funding for the winning bid would be ascribed across all suppliers.

In addition to ensuring service to all unassigned customer load, the Department has indicated a continuing desire to maintain discounts for low income, disabled or elderly customers and to address their particular needs.⁴ Unitil/FG&E believes that these customers can be provided the same proportionate rate discounts for distribution services as they presently receive, but that energy services should be fully market based. If the immediate result of the competitive market does not provide an equivalent benefit to such customers as they have historically received on the power supply portions of their bills, then the Department could consider alternative mechanisms for providing continuing benefits. Unitil/FG&E strongly recommends that such mechanisms not interfere with market pricing of energy services. Rather it could be accomplished through subsidies, with funding accomplished through the same funding mechanisms as described above for the unassigned customer load pool. In the alternative, or in addition, funding could be provided through wires charges collected by the distribution company.

⁴ This is defined in D.P.U. 96-100 as Universal Service. Unitil/FG&E recommends that the titles for Basic Service and Universal Service be switched to more appropriately identify the type of service described in the Department's order.

To further send correct pricing signals to the market, subsidies for low-income customers and other types of subsidies should be billed through the supplier of power, not the distribution company. Currently, every customer pays the subsidies in the form of a wires charge. By linking the subsidies to supply, customers will receive more accurate market signals.

2. Franchise Borders

The Department should not attempt to prevent existing competition between distribution companies that currently occur on franchise borders. See D.P.U. 96-100, p. 40 n.28 (May 1, 1996). Customers should be free to consider all available alternatives for lowering energy costs and to avail themselves of better opportunities where the existing franchise line does not present a barrier. The Department, in restructuring the industry, should not create additional franchise rights greater than those that currently exist.

G. Stranded Costs

Unitil/FG&E agrees with the position of other investor-owned utilities that the Department must provide a fair opportunity for utilities to recover their prudently-incurred stranded costs, and need not reiterate those arguments here. Incentives, if any, should not be directed at the divestiture of generation, but perhaps should be directed at the divestiture of transmission. As discussed above, the key market power concerns in restructuring the electric industry is the separation of generation and transmission.

Unitil/FG&E believe that stranded cost charges should be reflected on customers' bills as a part of the supplier's charge, not part of the distribution

charge. The Department should implement a supplier access charge, along the example of the telecommunications model. Such an allocation of the stranded cost charge will send appropriate price signals and accurately identify all power supply costs.

H. Performance Based Rates

Performance based rates for distribution service must take into account the fact that some companies have already increased their distribution, management, operation and maintenance efficiency. Unitil/FG&E has been extremely successful in increasing its operational efficiency, thus contributing to its success in avoiding price increases for its customers. If all distribution companies are allowed to start off at the same point, those companies that have already achieved some measure of energy efficiency would not be given the benefit of their past efforts. The Department should develop a mechanism to recognize the achievement of operating efficiencies through past management practices.

I. Regulatory Authority

While Unitil/FG&E supports full competition in the generation and retail marketing of electricity, the Company continues to be concerned about the statutory basis for the Department's restructuring efforts. See Initial Comments of Unitil/FG&E, D.P.U. 95-30, pp. 9-11; Reply Comments of Unitil/FG&E, D.P.U. 95-30, pp. 9-13. As noted in Unitil/FG&E's comments in D.P.U. 95-30, the existing statutory framework of command and control regulation imposes upon electric utilities an obligation to sell electricity to all customers in its service territory in exchange for protection from the competitive marketplace. Id.; see

also Commonwealth Elec. Co. v. Department of Pub. Util., 397 Mass. 361, 368 (1986). The Department's proposed rules would fundamentally change this structure in a manner that is inconsistent with the existing statutes.

General Laws chapter 164 defines electric utilities as companies engaged in either the generation and distribution, or the sale and distribution, of electricity. G.L. c. 164, § 1. This is fundamentally different from the Department's rules which seek to recast electric utilities primarily as distribution companies and discourage ownership of generation facilities. The requirements of c. 164 which apply to an electric utility's generation, sales and distribution functions contemplate a comprehensive scheme of regulation of monopoly enterprises that are inconsistent with a competitive market.

Unitil/FG&E reiterates its position that the fundamental restructuring proposed by the Department must be accompanied by statutory revisions. While the Department has indicated its willingness to coordinate with the Legislature, there is no analysis in the proposed rules or accompanying order of the Department's statutory authority or necessary statutory amendments.⁵ In order to ensure that the Department's restructuring efforts are legally sustainable, Unitil/FG&E encourages the Department to identify the statutory amendments necessary to implement a competitive market for the generation and retail marketing of electricity, and to seek appropriate legislative authority for its restructuring initiative.

⁵ The proposed rules identify the regulatory authority as M.G.L. c. 164, §§ 69I, 76 and 94, which grant the Department siting, general supervisory and ratemaking authority. These statutes, however, do not grant the Department authority to fundamentally alter the statutory scheme of monopoly regulation of the sale of electricity.

III. REQUEST TO PRESENT ORAL TESTIMONY

Unitil/FG&E respectfully requests an opportunity to present oral testimony at the public hearings in this proceeding scheduled for June 10, 1996 through July 19, 1996.

Respectfully submitted,

**FITCHBURG GAS AND ELECTRIC
LIGHT COMPANY**

By its attorneys,

Paul K. Connolly, Jr.
Scott J. Mueller
Susan L. Geiser
LEBOEUF, LAMB, GREENE & MACRAE, L.L.P.
260 Franklin Street
Boston, MA 02110
(617) 439-9500

Dated: May 24, 1996

(BS27810.1)